



APPENDIX.

Sections 607 and 609, 1928 Revenue Act (Now Sections 3770 and 3775, Internal Revenue Code).

"Sec. 607. Effect of Expiration of Period of Limitation against United States.

"Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim."

"Sec. 609. Erroneous Credits.

"(a) Credit against barred deficiency.—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607."

Finance Committee Report (Report 960, 70th Congress, 1st Session) Dealing with Sections 607 and 609, 1928 Revenue Act.

"Sec. 607. Effect of Expiration of Period of Limitation against United States.

"Section 1106(a) of the 1926 act failed to resolve many doubtful questions as to the legal effect which follows the expiration of the period of limitation prescribed for the assessment or collection of a tax or for the making of a refund or credit or the bringing of a suit for refund. Section 1106(a) of the 1926 act is repealed as of its effective date and is replaced by sections 607, 608, 609, and 610 of this bill.

Section 607 of the bill prescribes the effect to be given to the expiration of a period of limitation against the United States and section 608 relates to the effect of the expiration of a period of limitation against the taxpayer.

"Section 607 provides that regardless of the correct tax liability any payment shall be an overpayment if made pursuant to an assessment after the expiration of the period of limitation on assessment (no assessment hav-

ing been made within such period) or after the expiration of the period of limitation on collection by distraint or court proceedings (no distraint or court proceeding having been begun within such period). It is immaterial whether the payment was voluntary or involuntary, and duress is also of no significance in determining the right to recover an amount paid after the statute has run. An overpayment under section 607 is to be credited or refunded the same as any other overpayment.

"Section 607 is applicable to payments made before or after the enactment of this act. Any such overpayment shall be credited or refunded, however, only if claim therefor is filed within the proper period of limitation.

"Sec. 609. *Erroneous Credits.*

"Section 609 provides that a credit of an overpayment against a barred deficiency or a credit of a barred overpayment against a deficiency which is not barred shall be void if payment of the deficiency in the first case or the making of a refund in the second would constitute an overpayment or an erroneous refund under section 607 or 608.

"Section 609 applies to any credit made before or after the enactment of this act."

**Report of the Standing Committee on Federal Taxation,
American Bar Association Meeting, September, 1937.**

While there are impressive arguments in favor of courts' seeking to 'do justice' in particular cases, so far as is possible without violating the letter of the statute, it is beginning to be clear that if courts go too far into the legislative field in adjudicating tax cases, the public interest will be injured by gradually driving more and more tax cases into the courts. The more lawsuits a taxation system produces, the worse for the Government and its revenues; administrative processes are in general better adapted to revenue collection. Uncertainty as to the final outcome produces lawsuits, and uncertainty is produced whenever the outcome of a case is made to depend on the rough justice of that particular case. Taxation legislation is peculiar, in that it contemplates as a normal thing a vast number of transactions between the Government and its citizens, and those transactions cannot proceed in an orderly administra-

tive way unless the final result is reasonably predictable.

In older court opinions over a long period, statements are frequently found that if a statute is inequitable either to the taxpayer or to the Government, the remedy lies with Congress. This position was in part predicated on the consideration that for many years it has been the practice of Congress to give frequent attention to revenue laws, amending them when they needed it—the theory being that when a doctor is present, there is little reason for a layman to prescribe. In later years, however, the courts have occasionally shown a somewhat different tendency—to go beyond the mere ‘interstices’ and to soften or stiffen the law by interpretation according to their views of the case before them. This tendency has, perhaps, been more observable when the so-called ‘equities’ were urged in favor of the Government. Even when the Government succeeds in urging such an equitable construction, the ultimate result may be against the Government’s interest, because in subsequent cases, where the positions of the Government and the contending taxpayers are reversed, the result is to confuse a statute which need not have been confused.

Tendencies to apply a rather one-sided equitable construction are, perhaps, being checked even now, as may be indicated by the more careful position taken by the courts in very recent decisions in cases where the Government sought to estop a taxpayer from relying on the true facts.

It is the view of the Committee that the substantial number of tax cases pending in courts at this time is in part due to the unpredictability as to the result in many problems affecting the revenue and that this situation is fostered in part by ‘rough justice’ in court decisions.

Section 820, 1938 Revenue Act (Now, as Amended, Section 3801, Internal Revenue Code).

SEC. 820. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.*—For the purpose of this section—

(1) *Determination.*—The term “determination under the income tax laws” means—

(A) A closing agreement made under section 606 of the Revenue Act of 1928, as amended;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Commissioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which has become final, or claim for refund finally disposed of, prior to ninety days after the date of the enactment of this Act.

(2) *Taxpayer*.—Notwithstanding the provisions of section 901, the term “taxpayer” means any person subject to a tax under the applicable Revenue Act.

(3) *Related taxpayer*.—The term “related taxpayer” means a taxpayer who, with the taxpayer with respect to whom a determination specified in subsection (b) (1), (2), (3), or (4) is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor and beneficiary; (D) fiduciary and beneficiary, legatee, or heir; (E) decedent and decedent’s estate; or (F) partner.

(b) *Circumstances of Adjustment*.—When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Allows or disallows any of the additional deductions allowable in computing the net income of estates or trusts, or requires or denies any of the inclusions in the computation of net income of beneficiaries, heirs, or legatees, specified in section 162 (b) and (c) of this Act, and corresponding sections of prior revenue Acts, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer; or

(5) Determines the basis of property for depletion, exhaustion, wear and tear, or obsolescence, or for gain or loss on a sale or exchange, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediately or immediately the taxpayer derived title subsequent to such transaction—

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before, on, or after the date of enactment of this Act) or any provision of the internal-revenue laws other than this section and other than section 3229 of the Revised Statutes, as amended (relating to compromises), then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected

in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be. In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency, the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(c) *Method of Adjustment.*—The adjustment authorized in subsection (b) shall be made by assessing and collecting, or refunding or crediting, the amount thereof, to be ascertained as provided in subsection (d), in the same manner as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year with respect to which the error was made, and as if on the date of the determination specified in subsection (b) one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year.

(d) *Ascertainment of Amount of Adjustment.*—In computing the amount of an adjustment under this section there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be (1) the tax shown by the taxpayer, with respect to whom the error was made, upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpayer upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or

decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error. The amount so ascertained (together with any amounts wrongfully collected, as additions to the tax or interest, as a result of such error) shall be the amount of the adjustment under this section.

(e) *Adjustment Unaffected by Other Items, etc.*—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this section, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error.

(f) *No adjustment for Years Prior to 1932.*—No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932.

Finance Committee Report (Report 1567, 75th Congress, 3rd Session) Dealing with Section 820, 1938 Revenue Act.

SECTION 819. MITIGATION OF THE EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

This section of the bill provides an equitable solution of certain classes of income-tax problems, now very numerous, which have caused much hardship to taxpayers and great difficulty to the Commissioner, the Board of Tax Appeals, and the courts. The general nature of these problems is best disclosed by examples:

A. Taxpayer A, who reports income on the cash basis, erroneously included in his return for 1933 an item of accrued rent, and upon audit the return was accepted as filed. In 1938, after the period of limitations on refund claims for 1933 had expired, the Commissioner discovered that A received this rent in 1934, and consequently asserted and, after decision of the Board of Tax Appeals upholding

such assertion, collected a deficiency assessment for the latter year. To prevent A from being subjected to an unfair double tax burden on account of a single item of income, an adjustment would be made under the proposed legislation.

B. A father and son conducted a partnership business in which each had an equal interest. The father included the entire partnership income in his return for 1933 and the son included no portion of this income in his return for that year. One week before the statute of limitations had run with respect to deficiencies and refund claims for both father and son for 1933, the father filed a refund claim for that portion of his 1933 tax attributable to the half of the partnership income which should have been included in the son's return. The court sustained the claim for refund. To prevent the two partners from entirely avoiding payment of tax with respect to one-half of the partnership income through such inconsistent action by the father, an adjustment would be made under the proposed legislation.

C. In 1931 the taxpayer received securities of corporation A having a fair market value of \$5,000 in exchange for securities of corporation B which cost him \$12,000. The taxpayer treated the exchange as one in which gain or loss was not recognizable and upon audit the return was accepted as filed. He sold the A securities in 1937 for \$15,000 and reported \$3,000 gain. After the statute of limitations had run on refund claims for 1931, the Commissioner asserted a deficiency for 1937 on the ground that the loss realized on the exchange in 1931 was erroneously treated as nonrecognizable, and that the basis for gain or loss upon the sale was \$5,000, resulting in a gain of \$10,000. The taxpayer and the Commissioner then entered into a closing agreement for 1937 in which the taxpayer agreed to the Commissioner's determination. To prevent the inconsistent resort to the lower basis resulting in complete denial of a deduction for the loss sustained in 1931, an adjustment would be made under the proposed section.

In each case, under existing law, an unfair benefit would have been obtained by assuming an inconsistent position and then taking shelter behind the protective barrier of the statute of limitations. Such resort to the statute of limitations in a plain misuse of its fundamental purpose. The purpose of the statute of limitations to prevent the litiga-

tion of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him, if he assumes a position diametrically opposed to that taken prior to the running of the statute. The Federal courts in many somewhat similar tax cases have sought to prevent inequitable results by applying principles variously designated as estoppel, quasi-estoppel, recoupment and set-off. For various reasons, mostly technical, these judicial efforts cannot extend to all problems of this type. Nor can they provide a uniform, systematic solution of these problems. Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.

The legislation here proposed is based upon the following principles:

(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax saved with respect to the influence of the particular items involved in the adjustment.

(2) Subject to the foregoing principles, disputes as to the year in which income or deductions belong, or as to the person who should have the tax burden of income or the tax benefit of deductions, should never result in a double tax or a double reduction of tax, or an inequitable avoidance of tax.

(3) Disputes as to the basis of property should not allow the taxpayer or the Commissioner to obtain an unfair tax advantage by taking one position at the time of the acquisition of property and an inconsistent position at the time of its disposition.

(4) Corrective adjustments should produce the effect of attributing income or deductions to the right year and the right taxpayer, and of establishing the proper basis.

Other provisions of the internal revenue laws, as well as the statute of limitations, make profitable the taking of inconsistent positions by providing a safe shelter for the

party changing his position. Thus, in example A, suppose the statute of limitations had not yet run on refund claims for 1933 when the Commissioner asserted a deficiency for 1934, but the taxpayer and the Commissioner had entered into a closing agreement for the year 1933 so that the taxpayer would be prevented from reopening that year. The result of a double tax would likewise follow from the collection of the deficiency. While cases involving these other provisions are less frequent, the results produced are just as inequitable, and as they admit of the same adjustment as cases involving the statute of limitations, they are also covered by the proposed legislation.

Subsection (b) provides that the effect of the error shall be corrected in the manner provided in this section only if, at the time the determination becomes final, correction would be prevented by some provision of the internal revenue laws. Thus, in example A above, if the period for filing claims for refund had not expired at the time the decision of the Board sustaining the deficiency for 1934 became final so that the taxpayer could proceed to file a refund claim for 1933, this section would not be operative. In other words, this section does not prescribe an exclusive procedure for correcting the errors dealt with, but merely authorizes this particular procedure if correction is otherwise prevented. It should be observed that the section applies either where correction is barred by the running of the statute of limitations, by the execution of a closing agreement, by the collateral consequences of a Board proceeding, etc., prior to the date of enactment of this act, or by similar events happening after the effective date of this act.

Inasmuch as an adjustment should not be made until the inconsistent position asserted by the taxpayer or the Commissioner has been successfully maintained, subsection (b) is not operative until there is a final "determination" which gives authoritative sanction to the inconsistent action. Subsection (a) describes the types of determinations which are prerequisite to the operation of this section.

Subsection (b), with the interpretations afforded by the definitions in subsection (a), describes the circumstances under which an adjustment is authorized by this section. As the above examples indicate, the section is not restricted to single taxpayers but covers two or more taxpayers in appropriate cases. Paragraphs (1)-(4) of subsection (b)

group these taxpayers under the term "related taxpayer" and this term is defined in paragraph (2) of subsection (a). The definition covers those situations in which, for reasons apparent from the nature of the relationship, the problems dealt with by this section are likely to arise. Paragraph (5) of subsection (b) covers both the person who acquired the property and any subsequent transferees and donees who have a substituted basis ascertained by reference to the basis in the hands of such person.

It should be noted that only such transfers as occur subsequent to the transaction erroneously treated are covered by this paragraph, so as to avoid the confusion, hardship, and wasted effort which would result if reorganizations and other transactions were entirely readjusted when any one participant took inconsistent stands. For example, if partnership assets are transferred to a corporation in exchange for its stock and one of the partners on later disposition of the stock adopts a position with respect to the basis of the stock inconsistent with that taken at the time of the transfer, an adjustment would be made under this section only with respect to such partner. If the other partner, however, later shifted his position, an adjustment with respect to him would then be authorized under this section. An adjustment with respect to the corporation is not authorized by reason of the inconsistent position taken by either or both of the partners as the corporation derived title at the time of the erroneously treated transaction and not subsequent thereto. But if the corporation later shifted its position, an adjustment with respect to the corporation would then be authorized.

The adjustment is described in subsections (c), (d), and (e). Subsection (c) describes the first stage in the process, that of ascertaining the amount of the adjustment. In ascertaining the amount of the adjustment, two steps are involved;

(a) The tax previously determined for the taxable year with respect to which the error was made must first be ascertained. In ordinary cases this will simply be the amount of tax shown on the taxpayer's return. If any changes in the amount have been made, however, they must be taken into account. In such cases, the tax previously determined will be the tax as shown on the return, increased by any amounts previously assessed as deficiencies and decreased by any amounts previously repaid in respect of such tax.

(b) With the tax previously determined as the datum point, a recomputation must then be made to ascertain the increase or decrease, if any, resulting from correction of the error. In the ordinary case this will merely require a recomputation of the tax shown on the return, as affected by correct treatment of the item involved in the determination. If the amount of tax shown on the return had previously been increased or decreased by reason of deficiencies assessed or amounts repaid, the return would in effect be reconstructed to reflect these changes and the recomputation to ascertain the increase or decrease made on the basis of such reconstructed return. Such increase or decrease, together with any amounts wrongfully collected from the taxpayer, as additions to the tax or interest, as a result of the error, constitutes the amount of the adjustment.

The recomputation does not involve consideration of the treatment of any other items for the taxable year with respect to which the recomputation is made, except, of course, those items considered in ascertaining the tax previously determined to serve as the basis of the recomputation. Thus, in example A, if the taxpayer had failed to take a deduction properly allowable for a loss sustained in 1933, and the statute had run on claims for refund, the recomputation to ascertain the change necessitated by correction of the erroneous inclusion in gross income of the rent item would not permit correct treatment of the loss. Similarly, if the taxpayer had failed to include in his gross income commissions received in that year, and the statute had run on deficiency assessments, the recomputation would not permit inclusion of such commissions.

As indicated above, this section is predicated on the principle that correction is made only with respect to the item involved in the determination. The operation of the bar of statute of limitations is not affected with respect to any other item, even though such other item also had been erroneously treated in the same year. As to these items there has been no change of position, no double tax or double deduction, to call for the relief provided by this section. Accordingly, if the amount of the adjustment in example A ascertained by a recomputation of the tax after exclusion of the rent item from gross income were a decrease of \$500 in tax, and the inclusion of the commissions erroneously omitted from the return would have not only eliminated such decrease but would have resulted in a \$100

increase in tax, the amount of the adjustment nevertheless remains \$500 decrease in tax and, under subsection (d), is to be refunded to the taxpayer.

Subsection (d) prescribes the method of adjustment. If the amount of the adjustment ascertained pursuant to subsection (c) represents an increase in tax, it is to be considered as a deficiency for the taxable year with respect to which the error was made; if it represents a decrease in tax, it is to be considered as an overpayment for that year. The amount of the adjustment considered as a deficiency or as an overpayment, as the case may be, will bear interest to the extent provided by the internal revenue laws for deficiencies and overpayments for the taxable year with respect to which the error was made. Likewise, if the amount of the adjustment represents an increase in tax, any appropriate additions to the tax are also to be assessed and collected. By considering the amount of the adjustment as a deficiency or as an overpayment, subsection (d) permits the utilization of the procedural devices applicable to assessment, collection, refunding, etc., of deficiencies and overpayments.

Subsection (e) supplements the limitations provided in subsection (c) to the effect that the adjustment is unaffected by any other items not taken into consideration in ascertaining the tax previously determined.